Turbulent Firms, Turbulent Wages?

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Abstract

Has more turbulence among firms fueled rising wage instability in the US? Gottschalk and Moffitt (1994 and 1995) find that rising earnings instability was responsible for one third to one half of the rise in wage inequality during the 1980s. These growing transitory fluctuations remain largely unexplained. To help fill this gap, this paper further documents the recent rise in transitory fluctuations in compensation and investigates its linkage to the concurrent rise in volatility of firm performance. Recent work by Comin and Mulani (2005), among others, finds that the volatility of firm-level variables such as the growth rate of sales, employment or sales per worker, or the profits to sales ratio, have trended upward trend since at least 1970.

After examining models of how firm and wage volatility might be linked, we investigate the linkage in three complementary panel data sets, each with its own virtues and limitations: COMPUSTAT (detailed firm information, but only average wage and employment levels about workers), the Panel Study of Income Dynamics (PSID, detailed information on workers, but no information on employers) and the Federal Reserve Bank of Cleveland's Community Salary Survey (wages and employment levels for detailed occupations for identified firms). We find complementary support for the hypothesis in all three data sets. We can rule out straightforward compositional churning as an explanation for the linkage to firm performance in high-frequency (over spans of 5 years) wage volatility, although not in more persistent fluctuations (between successive 5 year averages). We conclude that the rise in firm turbulence explains about half of recent the rise in high frequency (5-year) volatility of wages.